# Indirect Expropriation: Conceptual Realignments?

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At a time when national policies concerning international economic relations are increasingly characterized by concepts aiming at structural adjustment, good governance and export-led growth, and when many countries find themselves in fierce competition for foreign direct investment, the era of straightforward formal expropriations of alien property seems to have come to an end. At the same time, however, the need for protecting certain public goods, be it in the areas of social cohesion or environmental protection, remains on the agenda of most, if not all, political actors. Against this backdrop, it does not seem unreasonable to assume that pressure on national governments – open or disguised – to protect domestic industries, the environment, or public health may encourage governments to regulate foreign investment, in itself or as part of the general economy, so drastically that foreign investors may be inclined to raise claims of indirect expropriation. The precise definition of what constitutes an expropriation is thus likely to continue to engender legal debates and disputes. This is even more so considering the growing number of bilateral investment treaties ("BITs").

Before turning to takings clauses in the modern treaty context and relevant customary law, it will be noted that modern BITs typically include general clauses such as "fair and equitable treatment", "full and constant protection" and "national treatment". While highly relevant and possibly overlapping in the context of indirect expropriation, the scope and precise substance of these broad rules in the very specific context of protection of foreign investments is rather difficult to clarify and is likely to evolve in a casuistic manner. During the mid-1980s, the relevant issues were said to be highly uncertain.[1] As a number of pronouncements by arbitral tribunals have since been added to the stock of relevant cases, one might have hoped for a greater sense of clarity.[2] Unfortunately, such clarity does not appear to have emerged.

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[1] Dolzer, Indirect Expropriation of Alien Property, 1 ICSID Review – Foreign Investment Law Journal (1986), 41 at 59.

[2] It is widely assumed, both in the business and legal community, that the international takings doctrine is in disarray, that the jurisprudence is inconsistent and that results are rarely predictable. The notion is notoriously underlined, for instance, by the impressive

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One prominent aspect of questions of indirect expropriation is the role, if any, that the purpose and circumstances of a particular governmental action can play in the legal assessment of whether expropriation has occurred.[3] At the outset, it is useful in this context to point to the various efforts that have been made in the past by prominent institutions and authors to modify or restate the rules of international law as they have evolved. These efforts can and should serve as a starting point in any discussion of whether or not an expropriation can be said to have occurred. As will be seen, however, these statements do not give a clear answer either. Some of the most representative of these attempts deserve to be quoted in full length inasmuch as they reflect past jurisprudence and scholarly opinion.

As early as 1961, the so-called Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, drafted by Professors Sohn and Baxter, assumed a taking to have occurred in the case of any "unreasonable interference with the use, enjoyment, or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference."[4]

Prior to this Draft, the codification of the relevant principles in the First Protocol of the European Convention on Human Rights in 1952 was based upon three distinct broad principles:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."[5]

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divergence of views in CME v. The Czech Republic, Partial Award of 13 Sept. 2001, para. 606, *and* Ronald S. Lauder v. The Czech Republic, Final Award, 3 Sept. 2001, para. 203 (*see* <http://www.mfcr.cz/index_en.php> visited 6 May 2003). Both cases addressed the same facts and reached very different conclusions.

[3] *See also* Dolzer, Indirect Expropriations: New Developments? 11 NYU Env. L. J. p. 64 (2002).

[4] Article 10, para. 3 (a); the Draft Convention is reproduced in 55 AJIL pp. 545, 553 (1961).

[5] Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, opened for signature Mar. 20, 1952, art. 1, 213 U.N.T.S. 262, 262. The European Court of Human Rights has interpreted this text in a number of decisions. The basic approach was laid down by the Court in Sporrong and Lönnroth (Judgement of 23 Sept.

In the 1967 OECD Draft Convention, an expropriatory act was defined as a measure applied in such a way "as to deprive ultimately the alien of the enjoyment or value of his property, without any specific act being identifiable as outright deprivation. As instances may be quoted excessive or arbitrary taxation; prohibition of dividend distribution coupled with compulsory loans; imposition of administrators; prohibition of dismissal of staff; refusal of access to raw materials or of essential export or import licenses".[6]

In the 1980s, the Restatement (Third) of the Foreign Relations Law of the United States focused on the effect of taking, providing some illustrations and relying in part on the concepts of unreasonable interference, on undue delay and the effective enjoyment of property:

> "Subsection 1 applies not only to avowed expropriations in which the government formally takes title to property, but also to other actions of the government that have the effect of "taking" the property, in whole or in large part, outright or in stages ("creeping expropriation"). The state is responsible for foreign expropriation of property under subsection 1 when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory."

The next attempt at codification followed in the years 1995 to 1997, when the OECD attempted to set the rules for a multilateral investment treaty. This time, the draft included the following clause:

> "A Contracting Party shall not expropriate or nationalise directly or indirectly an investment in its territory of an investor of another Contracting Party or

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1982). The Court held in general that it will assume a right to compensation when it finds that no "fair balance was struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights" (p. 18). The Court has since stuck to this approach and further developed it in various factual settings.

[6] OECD Draft Convention on the Protection of Foreign Property, 12 Oct. 1967, 7 I.L.M. 117, 126; for its history, *see* Schwarzenberger, Foreign Investments and International Law (1969), p. 153 *et seq*. In the same period, the American Convention on Human Rights required compensation according to its Article 21, para. 1, 2: "Everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interest of society. No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law."

> take any measure or measures having equivalent effect (hereinafter referred to as 'expropriation') except: (a) for a purpose which is in the public interest, (b) on a non-discriminatory basis, (c) in accordance with due process of law, and (d) accompanied by payment of prompt, adequate and effective compensation …"[7]

With these broad clauses in mind, a next step in the identification of the law will be the search for precedents suitable for the legal analysis of specific issues and factual situations. In principle, this would be appropriate in cases governed by customary international law as well as in matters involving bilateral or multilateral treaties. For in order to establish the "ordinary meaning" (Article 31 of the Vienna Convention on the Law of Treaties) of a provision referring to "indirect expropriation" or a similar clause, it will be helpful to turn to this body of case law. Ignoring these cases would neither help to ensure an organic growth of foreign investment law nor enhance legal clarity based on jurisprudential consistency. Obviously, the option of substantive disagreement with a previously decided case always remains open, but an award which simply does not take note of these cases will inevitably raise questions as to the proper effort made by the deciding tribunal of placing a judgement in the given legal context.

Turning to the case law, it can be said that two schools of thought relating to this question have emerged. One line of argument, which shall hereinafter be called the "sole effect doctrine", principally restricts itself to focusing solely on the particular effect that a given measure has on the legal position of the investor. A second approach finds it inappropriate to stop the analysis there, tending instead to consider the wider context of a given case. In particular, this latter approach allows for taking into account the governmental interest involved and thereby paves the way for a more elaborate weighing and balancing exercise. In order further to illustrate the importance of deciding which route to follow and fully to understand the issues involved in the two approaches, one may ask: Is it of any relevance, for instance, whether a government restricts the right of an owner with a view to limiting the earning potential of property in general, or whether the government acts to counter a certain environmental threat and for this purpose deems itself compelled to limit rights of property owners? To put the question differently: Is there any specific point on the spectrum of the many diverse effects on property of governmental measures at which and beyond which compensation is required regardless of the objective and the nature of the governmental measure? Is a balancing of interests which weighs the effect on the property against the objective of the

[7] OECD Doc. DAFFE/MAI(98)7/REV1, 22 April 1998, p. 56.

governmental measure always required? Indeed, is it conceivable that in certain settings the intention of the government must actually be given more weight than the effect on the owner? Whatever the basis and the justification of the "sole effect theory", it seems plain that a balancing concept may under certain circumstances lead to results different from those reached under an analysis which focuses only on the effect of the measure, for instance, in such areas as environmental regulation.

In light of the reasoning and results of some relevant cases, did past jurisprudence favor an approach which emphasized the effect on the owner as the sole criterion, or were other criteria used in a multifactor or balancing test? Cases supporting both lines of argument can be found.[8]

**The Chinn – Sea Land – S.D. Myers Line**

In the *Oscar Chinn* Judgement decided by the Permanent Court of International Justice,[9] the interests of some British shipping business on the Congo River were in question. This business had to close down operations due to the competitive consequences of the reduction of prices charged by the only competitor. The Belgian Government had ordered this lowering of prices by the competitor (Unatra) in order to keep the transport system on the river viable, and it had granted corresponding subsidies to Unatra, but not to the British Chinn company. The PCIJ concluded that there was no expropriation: "Favorable business conditions and good-will are transient circumstances, subject to inevitable changes".[10]

In 1984, the Iran-United States Claims Tribunal in *Sea-Land Service, Inc. v. Iran* found it important to highlight that there was no deliberate governmental interference on the part of the government and no intentional course of conduct directed against Sea-Land. It held:

> "A finding of expropriation would require, at the very least, that the Tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea-Land's operation, the effect of which was to deprive Sea-Land of the use and benefit of its investment. Nothing has been demonstrated here which might have amounted to an intentional course of conduct directed against Sea-Land. A claim founded substantially on omissions in a situation where the evidence

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[8] For a more elaborate summary *see* Dolzer, Indirect Expropriations: New Developments? 11 NYU Env. L.J. p. 80 (2002).

[9] PCIJ, Series A/B, No. 63 (1934), p. 65.

[10] *See* p. 85 *et seq.*; *see similarly* the Goetz Case, 15 ICSID Review – Foreign Investment L. J. pp. 505, 407 (2000).

> suggests a widespread and indiscriminate deterioration in management, disrupting the functioning of the port of Bandar Abbas, can hardly justify a finding of expropriation. Thus the claim against the Government of Iran based on expropriation must be dismissed."[11]

In *S.D. Myers Inc. v. Canada*, a case dealt with under the NAFTA Investment Chapter,[12] the plaintiff was registered as a U.S. corporation and specialized in the disposal of polychlorinated biphenyl ("PCB"), a substance recognized as being highly toxic and harmful to both human and animal health. Plaintiff had a major share of the U.S. PCB disposal market and entered the Canadian market in 1993. In 1995, plaintiff was successful in its efforts vis-à-vis the relevant U.S. agencies to lift the ban against imports of PCB from Canada into the United States. Canadian PCB disposal industry subsequently objected to the competitive situation created by the U.S. decision. In November 1995, Canada in effect banned the export of PCBs from its territory, thus destroying the possibility for plaintiff to export PCB and to dispose of it in its U.S. plants. S.D. Myers claimed *inter alia* that the Canadian measures were "tantamount to an expropriation" and had violated Article 1110 of NAFTA, providing that "no party shall directly or indirectly … expropriate an investment … or take a measure tantamount to … expropriation …". The Tribunal disagreed, pointing out that Canada "realized no benefit from the measure", and that no "transfer of property or benefit directly to others" had occurred. Moreover, the initiative was only "valid for a time". Under the circumstance, "[a]n opportunity was delayed", but no creeping expropriation could be found.[13] In principle, the Tribunal in *S.D. Myers* assumed that Article 1110 was to be interpreted "in light of the whole body of state practice, treaties and judicial interpretations of that term ['expropriation'] in international law cases." It emphasized that "[i]n general", a taking required a "transfer of ownership to another person …". The Tribunal concluded that "[t]he general body of precedent usually does not treat regulatory action as amounting to expropriation". Along the same lines, the Tribunal found:

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[11] 6 Iran-U.S. C.T.R., p. 149, 166 (footnotes omitted).

[12] S. D. Myers Inc. *v.* Canada, Partial Award, 121 I.L.R. 72.

[13] A similar approach was more recently adopted in the Lauder Case and in the Olguín Case. *See* Ronald S. Lauder *v.* The Czech Republic, Final Award, 3 Sept. 2001, (<http://www.mfcr.cz/index_en.php> visited 6 May 2003); Eudoro A. Olguín *v.* Republic of Paraguay, ICSID Case No. ARB/98/5, Award, 26 July 2001, (<http://www.worldbank.org/icsid/cases/paraguay-laudo.pdf> visited 6 May 2003).

> "Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference. The distinction between expropriation and regulations screens out most potential cases of complaints concerning economic intervention by a State and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs."

Moreover, in considering the phrase "tantamount to expropriation", the Tribunal stressed that "tantamount" was to be equated with "equivalent", and that this required that "the real interests involved and the *purpose* and effect of the government measure" rather than "technical or facial considerations" be decisive in this context.[14]

**The Tippetts – Biloune – Metalclad Line**

In contrast to the cases above, several other cases decided by arbitral tribunals in the past two decades have explicitly focused on the effect on the investor as the dominant or exclusive criterion marking the threshold between an expropriation and a mere regulation.

In *Tippetts*, decided by the Iran-United States Claims Tribunal, the appointment of a manager by the Iranian government to a U.S. engineering and architectural consulting business was at issue. Claimant's arguments that the measures amounted to an expropriation were accepted. The Tribunal held:

> "The Claimant is entitled under international law and general principles of law to compensation for the full value of the property of which it was deprived. The Tribunal prefers the term 'deprivation' to the term 'taking', although they are largely synonymous, because the latter may be understood to imply that the Government has acquired something of value, which is not required. A deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected. While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less important than the effects of the measures on

[14] S. D. Myers Inc. *v.* Canada, Partial Award, 121 I.L.R. 72, 123, para. 285 (emphasis added).

> the owner, and the form of the measures of control or interference is less important than the reality of their impact."[15]

An approach similar to the *Tippetts* rationale was followed in *Biloune v. Ghana Investment Centre*, decided in 1989:

> "The motivations for the actions and omissions of Ghanaian governmental authorities are not clear. But the Tribunal need not establish those motivations to come to a conclusion in the case. What is clear is that the conjunction of the stop work order, the demolition, the summons, the arrest, the detention, the requirement of filing assets declaration forms, and the deportation of Mr Biloune without possibility of re-entry had the *effect* of causing the irreparable cessation of work on the project. Given the central role of Mr Biloune in promoting, financing and managing MDCL, his expulsion from the country effectively prevented MDCL from further pursuing the project. In the view of the Tribunal, such prevention of MDCL pursuing its approved project would constitute a constructive expropriation of MDCL's contractual rights in the project and, accordingly, the expropriation of the value of Mr Biloune's interest in MDCL, unless the Respondents can establish by persuasive evidence sufficient justification for these events."[16]

A third unequivocal pronouncement in favour of the effect doctrine can be found in *Metalclad v. Mexico*,[17] a decision rendered in 2000. The case concerned a dispute over the treatment of a U.S. company which had been granted a permit for the development and operation of a hazardous waste landfill by the Mexican Federal Government, and which subsequently ran into difficulties due to actions taken by Mexican local and state authorities. The Tribunal found a violation of Article 1110 of NAFTA. The Tribunal construed the clause broadly:

> "… expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert and incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic

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[15] Tippetts, Abbett, McCarthy, Stratton *v.* TAMS-AFFA *et al.*, 6 Iran-U.S. C.T.R. 219, 225 (1984) (footnotes omitted).

[16] 95 I.L.R. 183, 209 (emphasis added).

[17] Metalclad Corporation *v.* United Mexican States, 119 I.L.R. 615, 638.

benefit of property even if not necessarily to the obvious benefit of the host State".[18]

A Canadian court reviewing this decision found that the Metalclad Tribunal gave an extremely broad definition of expropriation for the purposes of Article 1110.[19]

While the *Tippetts – Biloune – Metalclad* line represents the most direct exposition of the "sole effect doctrine", it must be added that other decisions by the Iran-United States Claims Tribunal such as *Starrett Housing*[20] and *Phelps Dodge*[21] in one way or another seem to support this line of reasoning. Likewise, more recently, the *Santa Elena* Award held that "there is ample authority for the proposition that a property has been expropriated when the effect of the measure taken by the states has been to deprive the owner of title, possession, or access to the benefit and economic use of its property."[22]

**The Case Law in Perspective**

In attempting to sum up these cases, it is clear that a line of cases can be cited in support of the "sole effect doctrine". Nonetheless, as pointed out above, there is also a line of reasoning in other cases which cannot be said to be of lesser importance. This second strand is not identical to the "sole effect doctrine", giving weight to the purpose and the circumstances of the respective governmental action. While the important role of the effect is not questioned by these cases, it is placed into a broader framework which allows a weighing and balancing of other relevant factors. Thus far, it does not seem possible to characterize either of the two approaches as dominant or as representing the mainstream of international thinking. At the same time, it is perhaps fair to say that the more recent jurisprudence of arbitral tribunals seems to reveal a tendency of shifting the focus of the analysis away from the context and the purpose to the effects on the owner.

Two segments of the jurisprudence are today beyond doubt. Firstly, the language in a number of decisions clearly shows a general consensus on the view that the severity of the impact upon the legal status and the factual impact on the

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[18] Metalclad Corporation *v.* United Mexican States, 119 I.L.R. 615, 638, para. 103.

[19] The United Mexican States v. Metalclad Corporation, 2001 BCSC 664. [2001] B.C.J. No. 950 (Q.L.), para. 99.

[20] 4 Iran-U.S. C.T.R., pp. 122, 154 *et seq.*

[21] 10 Iran-U.S. C.T.R., pp. 121, 130.

[22] Compañía del Desarrollo de Santa Elena, S.A. *v.* Costa Rica, Final Award, 5 ICSID Reports p. 153, at para. 77.

ability of an investor to use and enjoy his property always constitutes a cardinal factor in determining whether or not an expropriation can be said to have occurred. Secondly, the mere statement, after the event, by a government that a taking was not intended cannot, in itself, carry much weight in the analysis.

A survey of some takings cases and the principles given therein for determining the difference between a regulation and a taking does not allow the conclusion that the "sole effect doctrine" is already the dominant approach. Having said this, a caveat must, of course, be added. The above observations have to be considered in the full circumstances of each case, and a broader study of all cases, their factual setting and the arguments presented by the parties will therefore undoubtedly be required if a firmer conclusion is to be reached. Presumably, however, the main thrust of such a broader analysis would in its conclusions not depart significantly from those submitted here.

In any event, the proponents of the "effect doctrine" may argue that the issue is not whether certain public goods should be protected. It is rather whether the affected owner or the public should pay for the protection of that value. Furthermore, in line with the "sole effect doctrine", those voices in favour of a balancing and weighing process must concede that, at a certain point on the spectrum of the impact on the property, the effect must be accorded priority lest the protection of property amount to a concern for an empty shell. However, short of such a severe degree of impact, whenever reasonable use and enjoyment of property is not barred by the governmental measure, a process of weighing and balancing may, in certain circumstances, allow regulatory measures without compensation where the effect doctrine would call for a different solution. Of course, the key issue then is at what point the threshold between regulation and expropriation is reached.

When attempting to draw this line in future cases, it may be useful to keep in mind that the general clauses intended to identify takings in international law are in fact similar to the broad principles developed by national courts in the interpretation of constitutional rules both protecting property and allowing the exercise of legislative sovereignty in economic affairs. In this respect, it was suggested previously that general principles of law, as referred to in Article 38 of the Statute of the International Court of Justice, can be seen as an appropriate source of law of relevance in the present context.[23] Depending on the specific issue, they can be

[23] Dolzer, Indirect Expropriation of Alien Property, 1 ICSID Review – Foreign Inv. L. J. p. 53 (1986). In line with accepted doctrine, general principles will be identified on the basis of a comparison of the rules of major domestic legal orders governing property, legislative regulation and the law of expropriation.

helpful both in the context of applicable customary and treaty law. Having said this, it is also understood that the recognition and use of general principles in the context of expropriations cannot be seen as a panacea for all settings. First of all, on the practical level, the identification of these principles requires careful study of different domestic orders. Secondly, it will not be overlooked that even if the results of the relevant complex studies are on the table, the conclusions for purposes of international law may not always be entirely clear. In any event, changing notions of the common good and of the priority of social values as they may slowly shape national orders of property and the international environmental agenda will in due course also be reflected at the international level within the parameters of the takings doctrine. The logic inherent in the domestic orders as the basis for the general principles that are a source of international law forces a confluence of international law and the domestic legal orders.